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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 66

EMIL H. STRASSBURGER, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 3, 1942.

CERTIORARI GRANTED MAY 11, 1942.

SUPREME COURT OF THE UNITED STATES

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No. 66

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COMMISSIONER OF INTERNAL REVENUE

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JULY 22, 1942.

United States Circuit Court of Appeals

1

FOR THE SECOND CIRCUIT.

EMIL H. STRASSBURGER,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 100,303.

APPEARANCES: 2

For Taxpayer: LEO BRADY, ESQ.

For Commissioner: WALT MANDRY, ESQ.

Docket Entries.

1939

Oct. 11—Petition received and filed. Taxpayer notified. (Fee paid).

Oct. 11—Copy of petition served on General Counsel.

Nov. 24—Answer filed by General Counsel.

Nov. 24—Request for hearing in New York City filed by General Counsel. 3

Nov. 27—Notice issued placing proceeding on New York City Calendar. Answer and request served.

1940

Aug. 20—Hearing set October 21, 1940, New York City.

Oct. 24—Hearing had before Mr. Van Fossan on the merits. Submitted. Petitioner granted leave to file amendment to petition. Stipulation of facts filed. Appearance of Leo Brady filed. Amendment to petition filed. Answer to amendment to petition filed. Briefs due as per Rules.

Nov. 12—Transcript of hearing October 24, 1940, filed.

Dec. 6—Motion for extension to December 21, 1940, to file brief filed by General Counsel. December 9, 1940, granted.
Dec. 7—Brief filed by taxpayer.
Dec. 21—Brief filed by General Counsel.
Dec. 23—Copy of brief served on General Counsel.

1941

Feb. 10—Memorandum findings of fact and opinion rendered, Van Fossan, Division 9. Decision will be entered for the respondent.

5

Feb. 10—Decision entered, Van Fossan, Division 9.
May 5—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.
May 5—Proof of service filed by taxpayer.
June 27—Agreed praecipe for record filed—with proof of service thereon.

Petition.

(Filed October 11, 1939.)

6 UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

Docket No. 100,303.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, bearing no symbols, dated July 18, 1939, and as a basis of his proceeding alleges as follows:

(1) The petitioner is Emil H. Strassburger residing at 480 Park Avenue, New York, N. Y. The return for the period here involved was filed with the Collector for the Second District of New York.

(2) The notice of deficiency, a copy of which is hereto attached and marked "Exhibit A" was mailed to the petitioner on or about the date of the notice, July 18, 1939.

(3) The taxes in controversy are income taxes for the calendar year 1936, in the amount of $949.39. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) Inclusion in taxpayer's income of dividends in the amount of $5,000.

(4) The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a) The dividend in the amount of $5,000. was a stock dividend.

(b) Taxpayer owned all of the outstanding stock of the corporation which declared said dividend, namely, E. H. Strassburger, Inc.

(c) The stock dividend was in preferred stock—50 shares 7% cumulative with no voting rights.

(d) There was no change of the character of the taxpayer's interest in the said corporation.

(e) The dividend was not an artifice or device to evade the tax laws.

WHEREFORE, petitioner prays that this Board may hear the proceeding and determine no deficiency or liability.

EMIL H. STRASGBURGER.

10 *Petition.*

State of New York, }
County of New York, } ss.:

EMIL H. STRASSBURGER, being duly sworn, deposes and says: That he is the petitioner in the foregoing petition; that he has read the foregoing petition and knows the contents thereof; that the same is true to his own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters he believes it to be true.

11 EMIL H. STRASSBURGER.

Sworn to before me this
7th day of October, 1939.

A. K. PONS,
Notary Public, Queens Co. No. 1579,
Queens County Register's No. 2183,
New York County Register's No. O-P-180,
Certificate filed in N. Y. Co. No. 288,
Commission expires March 30, 1940.

(Seal)

12

13

EXHIBIT A.

TREASURY DEPARTMENT
Internal Revenue Service

Office of
Internal Revenue Agent in Charge
Second New York Division

July 18, 1939

Mr. Emil H. Strassburger
480 Park Avenue
New York, New York

14

Sir:

You are advised that the determination of your income tax liability for the taxable year ended Dec. 31, 1936, discloses a deficiency of $949.39 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

15

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, 90 Church Street, New York, N. Y., for the attention of LAL-90 D. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest,

since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING
Commissioner

By C. R. KRIGBAUM
Internal Revenue Agent in Charge

Enclosures
Statement.
Form of waiver.

EXHIBIT A.

STATEMENT

Mr. Emil H. Strassburger
480 Park Avenue
New York, New York.

Tax Liability for the Taxable Year Ended December 31, 1936

	Liability	Assessed	Deficiency
Income tax	$2,695.80	$1,746.41	$949.39

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 25, 1938; to your protest dated April 11, 1938; and to the statements made at the conferences held on November 18, 1938, and January 23, 1939.

A copy of this letter and statement has been mailed to your representative, Mr. Leo Brady, 535 Fifth Avenue, New York, New York, in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustment to Net Income

Net income as disclosed by return	$20,984.75
Unallowable deductions and additional income:	20
(a) Dividends	5,000.00
Net income adjusted	$25,984.75

Explanation of Adjustment

(a) The preferred stock of a par value of $5,000.00 issued to you by E. H. Strassburger, Inc., constituted income under the Sixteenth Amendment to the Constitution and, therefore, was not exempt from tax under the provisions of section 115 (f) of the Revenue Act of 1936 (see case of Frank J. and Hubert Kelly Trust, 38 B. T. A. #128). 21

Computation of Tax

Revenue Act of 1936

Net income adjusted	$25,984.75
Less: Personal exemption	2,500.00
Balance (surtax net income)	$23,484.75
Less: Earned income credit	1,400.00
Net income subject to normal tax	$22,084.75

22 *Answer.*

Normal tax at 4% on $22,084.75	$ 883.39
Surtax on $23,484.75	1,812.41
Total tax	$ 2,695.80
Correct income tax liability	$ 2,695.80
Income tax assessed:	
Original Account No. 212884	1,746.41
23 Deficiency of income tax	$ 949.39

Answer.

(Filed November 24, 1939.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

24 Docket No. 100,303.

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and in answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1936 in the amount of $949.39

as alleged in paragraph 3 of the petition but denies that the respondent committed error as alleged in said paragraph.

4(a). Admits the allegations contained in subparagraph (a) of paragraph 4 of the petition.

(b). Denies the allegations contained in subparagraph (b) of paragraph 4 of the petition.

(c). Admits the allegations contained in subparagraph (c) of paragraph 4 of the petition.

(d) and (e). Denies the allegations contained in subparagraphs (d) and (e) of paragraph 4 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinabove admitted or denied.

WHEREFORE, it is prayed that the determination of the Commissioner be approved and the appeal denied.

(Signed) J. P. WENCHEL,
ECA
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

E. O. HANSON,
Division Counsel,
WALT MANDRY,
Special Attorney,
Bureau of Internal Revenue.

KB
11/17/39

28

Amended Petition.

(Filed October 24, 1940.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

Docket No. 100,303.

29 The petition in the above matter, sworn to October 7, 1939, shall be and hereby is amende to include at the end of the present paragraph (4) (e) the following:

"(5) (a) The inclusion of the stock dividend in question in taxpayer's gross income and the determination of tax liability resulting therefrom is without warrant either under the United States Constitution, the Federal Statutes and Regulations with respect to the taxation of income thereunder."

"(5) (b) The Statutes and Regulations insofar as the same may purport to tax the stock dividend made 30 to the petitioner herein are illegal, unconstitutional and void for want of certainty, clarity and definiteness and impose no tax basis or formula for the computation of tax liability."

Dated, New York, October 23, 1940.

LEO BRADY,
Attorney for Petitioner.

31

Answer to Amended Petition.

(Filed October 24, 1940.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

Docket No. 100,303.

COMES Now the Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amendment to the petition filed in these proceedings admits and denies as follows: 32

5(a) and (b). Denies the allegations contained in subparagraphs (a) and (b) of paragraph 5 of the amendment to the petition.

WHEREFORE, respondent prays that the amended petition be denied and that the respondent's determination be in all respects approved.

33

(Signed) J. P. WENCHEL,
ECA
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

E. O. HANSON,
Division Counsel.

WALT MANDRY,
Special Attorney,
Bureau of Internal Revenue.

em 10-23-40

34

Memorandum Findings of Fact and Opinion.

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

Docket No. 100,303.

Petitioner, the owner of all the issued voting common stock of a corporation, which was the only stock
35 outstanding, received a dividend of 50 shares of nonvoting cumulative preferred stock. *Held*, that the preferred stock constituted a taxable dividend within the meaning of the Sixteenth Amendment to the Constitution. *John M. Keister*, 42 B. T. A. 484, followed.

LEO BRADY, ESQ., for the Petitioner.

WALT MANDRY, ESQ., for the Respondent.

Respondent determined a deficiency in petitioner's income tax for the year 1936 in the sum of $949.39. The
36 single issue before the Board is whether or not the receipt of a dividend of preferred stock by petitioner, sole owner of the issuing corporation's common stock, the only stock of the corporation outstanding, was income taxable to petitioner.

FINDINGS OF FACT.

The facts were stipulated substantially as follows:

Petitioner resides in New York, New York.

E. H. Strassburger, Inc., sometimes hereinafter referred to as the Corporation, is a New York corporation

organized in or about January, 1932, with its principal place of business at 740 Broadway, New York, New York.

On December 10, 1936, the authorized capital stock of the Corporation consisted of 200 shares of common stock with exclusive voting rights. All of this stock was owned by petitioner.

On December 11, 1936, the Corporation's articles of incorporation were duly amended for the creation and authorization of an issue of 500 shares of $100 par value, 7 per cent, cumulative, non-voting preferred stock.

On December 21, 1936, the board of directors of the 38
Corporation held a meeting at which a resolution was adopted of which the following is material:

> "Now, Therefore, Be It Resolved, that for the purpose of representing in the capitalization of this corporation surplus assets to the extent of Five Thousand Dollars, a distribution among stockholders of the capital stock of the corporation be made of Five Thousand Dollars of preferred capital stock, and the proper officers of the corporation are hereby authorized and directed to issue an aggregate of Five Thousand Dollars, par value of preferred capital stock 39
> of this corporation, in payment of a stock dividend on the common stock of this corporation.
>
> "Further Resolved, that the directors of this corporation be authorized to distribute said Five Thousand Dollars of the preferred capital stock, pro rata, among stockholders, as and for a stock dividend on said capital stock so owned by them, such distribution to be made to stockholders of record at the close of business on December 24, 1936."

On December 24, 1936, pursuant to the resolution adopted on December 21, 1936, 50 shares of preferred

40 *Memorandum Findings of Fact and Opinion.*

stock of the Corporation were issued to petitioner, the sole common stockholder. At the time of the distribution of the stock dividend the Corporation had earnings and profits accumulated subsequent to February 28, 1913, in excess of $5,000. Appropriate book entries were made on account of the dividend, decreasing the surplus of the Corporation by $5,000 and increasing its capital stock in the same amount.

On December 29, 1936, the 50 shares of preferred stock which petitioner had received as a dividend were trans-
41 ferred to his wife, Gertrude W. Strassburger. Upon her death the shares were retransferred to petitioner who is now the record holder. No dividends have been paid on the preferred stock and that stock has never been disposed of, canceled or retired.

OPINION.

VAN FOSSAN: The only issue for our determination is whether or not petitioner, holder of all the issued common stock of E. H. Strassburger, Inc., which was the
42 only stock of that corporation outstanding, received taxable income within the meaning of the Sixteenth Amendment to the Constitution upon receipt of a dividend of preferred stock. Petitioner contends that the dividend was not a taxable one because his proportionate interest in the Corporation did not change upon its receipt. He urges that even if the dividend were constitutionally taxable Congress did not intend to tax a dividend such as we have before us. Respondent argues that the dividend of the preferred shares changed the character of petitioner's interest in the Corporation and hence constitutes a taxable distribution.

The provisions of the statute here applicable are section 115 (a) and section 115 (f) of the Revenue Act of 1936[1].

We are of the opinion that the instant case is controlled by *John M. Keister*, 42 B. T. A. 484. In that proceeding we held that a dividend of non-voting common stock received by holders of voting common stock was a taxable dividend and said:

> • • • the nonvoting common stock was not "of precisely the same character" as the stock previously 44
> held by them. By the receipt of the dividend each holder of voting common stock received an "interest different from that which its former stockholdings represented." In making this observation we do not

[1] SEC. 115. DISTRIBUTION BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title (except in section 203 [a] [3] and section 207 [c] [1], relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made dur- 45
ing the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

• • • • • •

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

overlook the fact that the value of the additional non-voting common shares received was presumably no greater than a like number of voting common shares which would not be subject to income tax under the opinion in *Eisner* v. *Macomber, supra.* Probably the shares had a less value. But the interest was different, and we think that is all that is required to make the dividend taxable to the holders of voting common stock.

47 In *John M. Keister, supra,* we also considered the taxability of a dividend of non-voting preferred stock to holders of voting and non-voting common shares and stated:

> • • • These features [of the non-voting preferred] gave it an entirely different character from the voting and nonvoting common shares. It clearly represented a different interest in the corporation. It is true, as petitioners point out, that the preferred shares were not to be favored in case of liquidation or dissolution and it is to be noted further that their
48 issuance did not in any way affect the voting control of the corporation, but nevertheless, under the authoritative cases, they represented a new and different interest in the corporation and therefore constituted taxable income. *Koshland* v. *Helvering, supra; Frank J. and Hubert Kelly Trust, supra; Albert E. Smith,* 39 B. T. A. 80.

The preferred stock issued by E. H. Strassburger, Inc. gave petitioner rights different from those he possessed before. The stock carried with it the right to the payment of a fixed amount annually before any dividends upon the common stock could be paid. The fact that the

preferred stock was non-voting would allow petitioner to transfer that stock without changing his voting control. This certainly was an interest differing from his interest as a common shareholder. The dividend stock was also cumulative thus affecting in a material way petitioner's common stockholder interest. We hold that petitioner received a taxable stock dividend in the amount of the fair market value of the preferred stock.

Decision will be entered for the respondent.

Entered Feb. 10, 1941. 50

Decision.

UNITED STATES BOARD OF TAX APPEALS,

WASHINGTON.

[SAME TITLE]

51

Docket No. 100,303.

Pursuant to the determination of the Board, as set forth in its Memorandum Findings of Fact and Opinion, entered February 10, 1941, it is

ORDERED and DECIDED: That there is a deficiency in income tax of $949.39 for the year 1936.

Enter:

(Signed) ERNEST H. VAN FOSSAN,
Member.

Entered Feb. 10, 1941.

52 **Petition for Review.**

(Filed May 5, 1941.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

B. T. A. Docket No. 100,303.

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Second Circuit:

53

I.

Jurisdiction.

Emil H. Strassburger, your petitioner, respectfully petitions this Honorable Court to review the decision of the United States Board of Tax Appeals, entered on February 10, 1941, and finding a deficiency in income tax due from your petitioner for the calendar year 1936 in the amount of $949.39.

The return of income tax, in respect of which the
54 aforementioned tax liability arose, was filed by your petitioner with the Collector of Internal Revenue for the Second Collection District of New York, which is located within the jurisdiction of the Circuit Court of Appeals for the Second Judicial Circuit. Your petitioner at the time of said return resided and still resides at 480 Park Avenue, New York City.

Jurisdiction of this Court to review the decision of the United States Board of Tax Appeals is founded on Sections 1001-3 of the Revenue Act of 1926, as amended by Sections 603 of the Revenue Act of 1928, 1101 of the Revenue Act of 1932 and 519 of the Revenue Act of 1934.

II.

Nature of Controversy.

The parties hereto stipulated upon an agreed statement of facts substantially as follows:

The petitioner, Emil H. Strassburger, a resident of New York, was the sole owner of 200 shares of common stock of E. H. Strassburger, Inc., hereinafter referred to as the corporation. Said corporation was organized in or about January, 1932, under the laws of the State of New York and maintains its principal place of business at 740 Broadway, New York, New York. The shares of stock heretofore mentioned constitute the total authorized capital stock of the corporation and have exclusive voting rights. On December 11, 1936, the corporation's articles of incorporation were duly amended so as to create an issue of 500 shares of $100. par value 7% cumulative non-voting preferred stock. The Board of Directors of the corporation, at a meeting held on December 21, 1936, adopted a resolution, the material portion of which is as follows:

> "Now, Therefore, Be It Resolved, that for the purpose of representing in the capitalization of this corporation surplus assets to the extent of Five Thousand Dollars, a distribution among stockholders of the capital stock of the corporation be made of Five Thousand Dollars of preferred capital stock, and the proper officers of the corporation are hereby authorized and directed to issue an aggregate of Five Thousand Dollars, par value of preferred capital stock of this corporation, in payment of a stock dividend on the common stock of this corporation.

"FURTHER RESOLVED, that the directors of this corporation be authorized to distribute said Five Thousand Dollars of the preferred capital stock, pro rata, among stockholders, as and for a stock dividend on said capital stock so owned by them, such distribution to be made to stockholders of record at the close of business on December 24, 1936."

On December 24, 1936, pursuant to the aforesaid resolution, fifty shares of preferred stock of the corporation
59 were issued to the petitioner, Emil H. Strassburger, sole common stockholder. The corporation at the time of distribution of the stock dividend had earnings and profits accumulated subsequent to February 28, 1913, in excess of $5,000. Appropriate book entries were made on account of the dividend decreasing the surplus of the corporation by $5,000. and increasing its capital stock in like amount.

On December 29, 1936, the petitioner transferred to his wife, Gertrude W. Strassburger, the fifty shares of preferred stock which he had received as a dividend. Said shares were retransferred to petitioner upon the death of
60 his wife, and petitioner is now the record holder. The stock has never been disposed of, cancelled or retired and no dividends have been paid thereon.

The petitioner in his personal income tax return for the calendar year 1936 did not include the stock dividends in the amount of $5,000. He was notified of a deficiency in his tax for the said year and thereafter petition to the United States Board of Tax Appeals was duly filed.

The United States Board of Tax Appeals held that the petitioner received a taxable stock dividend in the amount of the fair market value of the preferred stock. The Board found that the preferred stock issued by E. H.

Strassburger, Inc. gave petitioner rights different from those he possessed before for the reasons:

(a) That the stock carried with it the right to the payment of a fixed amount annually before any dividends upon the common stock could be paid.

(b) That since the preferred stock was non-voting, petitioner could transfer that stock without changing his voting control.

III.

Assignment of Errors.

In making its decision as aforesaid, the United States Board of Tax Appeals committed the following errors upon which your petitioner relies as the basis of this proceeding:

1. The Board erred in holding that the preferred stock issued to petitioner gave him any rights different from those he possessed before.

2. The Board erred in holding that the dividend stock affected in a material way petitioner's common stockholder interests.

3. The Board erred in holding that petitioner received a taxable stock dividend in the amount of the fair market value of the preferred stock.

4. The Board erred in determining that there is a deficiency in income tax due from petitioners in the amount of $949.39 set forth in the final order of determination.

5. The Board erred in failing to determine that there was no deficiency in income tax due from petitioner.

6. The Board erred in failing to determine that the mere receipt of the stock dividend in question does not constitute taxable income to the petitioner under the Constitution, statutes and regulations, and any attempt to impose a tax thereon is without warrant.

7. The Board erred in failing to determine that the
65 statutes and regulations insofar as the same may purport to tax the stock dividend in question are illegal, unconstitutional and void, for want of certainty, clarity and definiteness and impose no tax basis or formula for the computation of tax liability.

WHEREFORE, your petitioner prays that this Honorable Court may review the decision and order of the United States Board of Tax Appeals and reverse and set aside the same and direct said Board to grant the relief sought by petitioner in his petition filed with said Board and to enter an order determining that there is no deficiency in
66 income tax for the calendar year 1936, due from petitioner, and for the entry of such further orders and directions as shall by this Court be deemed meet and proper in accordance with law.

(Signed) LEO BRADY,
Attorney for Petitioner.

State of New York, }
County of New York, } ss.:

LEO BRADY, being duly sworn, deposes and says:

I am the attorney for the petitioner in this proceeding. The foregoing petition was prepared under my supervision and I am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. The petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought. 68

LEO BRADY.

Sworn to before me this
2nd day of May, 1941.

AUGUSTA E. SCHULZ,
Notary Public, Kings County,
Kings Co. Clk's No. 122, Reg. No. 2141,
N. Y. Co. Clk's No. 320, Reg. No. 2S220,
Bronx Co. Clk's No. 14, Reg. No. 31S42,
Commission expires March 30, 1942. 69

70

Proof of Service.

(Filed May 5, 1941.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

B. T. A. Docket No. 100,303.

To:

71

COMMISSIONER OF INTERNAL REVENUE,
Internal Revenue Building,
Washington, D. C.

J. P. WENCHEL, Esq., Attorney for Respondent,
Chief Counsel,
Bureau of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

YOU ARE HEREBY NOTIFIED that on the 5th day of May,
72 1941, a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above entitled cause, was filed with the Clerk of the Board. A copy of the petition as filed is attached hereto and served upon you.

Dated, May 5th, 1941.

LEO BRADY,
Attorney for Petitioner,
165 Broadway,
City of New York.

Service of the foregoing notice of filing and a copy of the petition for review is hereby acknowledged this 5th day of May, 1941.

(Signed) J. P. WENCHEL,
Attorney for Respondent.

Agreed Statement of Facts.

(Filed October 24, 1940.)

UNITED STATES BOARD OF TAX APPEALS.

[SAME TITLE]

Docket No. 100,303.

IT IS HEREBY STIPULATED AND AGREED by and between the parties hereto that the following agreed statement of facts is true and that the case shall be submitted to the United States Board of Tax Appeals upon such agreed statement without testimony:

1. The Petitioner is EMIL H. STRASSBURGER, residing at 480 Park Avenue, New York, New York.

2. The return for the period here involved was filed with the Collector for the Second District of New York.

3. Taxpayer was notified of a deficiency in his personal income taxes for the calendar year 1936 in the amount of

76 *Agreed Statement of Facts.*

$949.39. Thereafter petition to the United States Board of Tax Appeals was duly filed.

4. The deficiency arises by virtue of the inclusion by the Respondent of dividends in the amount of $5,000.

5. The E. H. Strassburger, Inc., is a New York corporation organized in or about January, 1932, with its principal place of business at 740 Broadway, New York, New York.

6. On December 10, 1936, its authorized capital stock
77 consisted of two hundred (200) shares of common stock, with exclusive voting rights, all of which stock was owned by the petitioner.

7. On December 11, 1936, its articles of incorporation were duly amended so as to create and authorize the issuance of five hundred (500) shares of $100. par value, 7 per cent, cumulative, non-voting preferred stock.*

8. On December 21, 1936, at a meeting of its board of directors a resolution was adopted which, in part, reads as follows:

78 "Now, Therefore, Be It Resolved, that for the purpose of representing in the capitalization of this corporation surplus assets to the extent of Five Thousand Dollars, a distribution among stockholders of the capital stock of the corporation be made of Five Thousand Dollars of preferred capital stock, and the proper officers of the corporation are hereby authorized and directed to issue an aggregate of Five Thousand Dollars, par value of preferred capital stock of this corporation, in payment of a stock dividend on the common stock of this corporation.

* A specimen copy of certificate is hereto annexed, made part hereof and marked Exhibit "A".

"FURTHER RESOLVED, that the directors of this corporation be authorized to distribute said Five Thousand Dollars of the preferred capital stock, pro rata, among stockholders, as and for a stock dividend on said capital stock so owned by them, such distribution to be made to stockholders of record at the close of business on December 24, 1936."

9. On December 24, 1936, pursuant to the above resolution, 50 shares of the preferred stock were issued to the sole common stockholder, the petitioner, EMIL H. 80
STRASSBURGER.

10. At the time of the distribution of the stock dividend E. H. Strassburger, Inc. had earnings and profits accumulated subsequent to February 28, 1913, in excess of $5,000. and appropriate book entries were made on account of the dividend decreasing the surplus of the company by $5,000. and increasing its capital stock in the same amount.

11. On December 29, 1936, the said 50 shares of preferred stock were transferred to Gertrude W. Strass- 81
burger, wife of the petitioner. Upon her death the shares were re-transferred to petitioner, EMIL H. STRASSBURGER, who is now the record holder. No dividends have been paid on said preferred stock and said stock has never been cancelled, retired, or otherwise disposed of.

Dated, New York, October 23, 1940.

LEO BRADY,
Counsel for Petitioner.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Exhibit "A."

INCORPORATED UNDER THE LAWS OF THE STATE OF NEW YORK

NUMBER P

SHARES

SPECIMEN COPY

E. H. Strassburger Inc.

PREFERRED STOCK

THIS CERTIFIES THAT _____ is the owner of

fully paid and non assessable shares of the PREFERRED CAPITAL STOCK of E. H. STRASSBURGER INC. transferable only on the books of the corporation in person or by attorney upon surrender of this certificate properly endorsed.

The designations, preferences, privileges and voting powers of the shares of each class, and the restrictions or qualifications thereof, shall be as follows:

(a) The holders of the preferred stock shall be entitled to cumulative dividends thereon, at the rate of Seven ($7.00) Dollars per share per annum, and no more, payable out of any and all surplus or net profits of the corporation, as and when declared by the Board of Directors before any dividend shall be declared, set apart for, or paid upon the common shares of the corporation. Said dividends on the preferred stock shall be cumulative, so that if the corporation shall fail in any fiscal year to pay such dividends on all of the issued and outstanding preferred stock, such deficiency in the dividends shall be fully paid before any dividends shall be paid or set apart upon the common share. Subject to the foregoing provisions said preferred stock shall not be entitled to participate in any other or additional surplus or net profits of the corporation.

(b) In the event of the dissolution or liquidation of the corporation, or sale of all its assets, whether voluntary or involuntary, or in the event of its insolvency, or upon any distribution of its capital, there shall be paid to the holders of the preferred stock, the par value thereof, to wit: One Hundred ($100.00) Dollars per share, and the amount of all unpaid accrued dividends thereon, before any sum shall be paid or any assets distributed among the holders of the common shares, and after the payment to the holders of the preferred shares of its par value and the unpaid accrued dividends thereon, the remaining assets and funds of the corporation shall be divided among and paid to the holders of the common shares in proportion of their respective holdings of such shares.

(c) The preferred stock shall have no pre emptive right to or right to subscribe for any additional stock of whatever class, which may at any time be issued by the corporation.

(d) The corporation shall have the option of retiring or redeeming the preferred stock in whole or in part, at any time, from time to time, by paying to such holders thereof, the sum of One hundred and five ($105.00) Dollars for each share of preferred stock, together with any accumulated dividends thereon. Such retirement shall be effected by payment of the surplus fund, if any, of the corporation, but no preferred stock shall be redeemed for cash, under the circumstances, which would produce any impairment of the capital stock of the Company. That such retirement or redemption of the stock can only be effected on one (1) month's notice, which said notice shall be mailed to the stockholders whose stock is to be redeemed or retired, at the address of the stockholder as the same appears upon the stock books of the corporation.

(e) The entire voting power for the election of directors shall be vested in the holders of the common shares, and the holders of the preferred shares shall not be entitled to vote at the election of directors of said corporation or at any other meeting of stockholders for any purpose or on any subject, or to receive notice of any meeting of stockholders except as otherwise expressly provided by law.

IN WITNESS WHEREOF, the duly authorized officers of this corporation have hereunto subscribed their names and caused the corporate seal to be hereto affixed, this _____ day of _____ A D 19

CERTIFICATE

FOR

SHARES

OF THE

ISSUED TO

DATED

85

Praecipe With Proof of Service.

(Filed June 27, 1941.)

UNITED STATES BOARD OF TAX APPEALS.

B. T. A. Docket No. 100,303.

[SAME TITLE]

86

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver, to the Clerk of the United States Circuit Court of Appeals, for the Second Circuit, copies duly certified as correct of the following documents and records in the above entitled cause in connection with the Petition for Review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the above named Petitioner:

1. Docket entries of the proceedings before the Board.
2a. Petition filed on October 11, 1939.
2b. Answer to petition filed on November 24, 1939.
2c. Amendment to petition, filed on October 24, 1940.
2d. Answer to amendment to petition, filed on October 24, 1940.
3a. Findings of Fact and Opinion of the Board, promulgated on February 10, 1941.
3b. Decision of the Board entered on February 10, 1941.
4a. Petition for Review filed on May 5, 1941.
4b. Notice of filing Petition for Review, filed on May 5, 1941.

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88 *Praecipe With Proof of Service.*

5a. Agreed Statement of Facts in lieu of Statement of Evidence.

5b. This Praecipe for Record.

5c. Notice of filing this Praecipe for Record and the admission of service thereof.

Said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Second Circuit.

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LEO BRADY,
Attorney for Petitioner.

Service of a copy of this praecipe is hereby admitted this 27th day of June, 1941.

Agreed to.

(Signed) J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

90

RAW/JPW 6-27-41
JMM 6-27-41.

91

Clerk's Certificate.

UNITED STATES BOARD OF TAX APPEALS,

WASHINGTON.

Docket No. 100,303.

EMIL H. STRASSBURGER,

Petitioner,

VS.

92

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

I, B. D. GAMBLE, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 29, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

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In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 30th day of June, 1941.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

(Seal)

[fol. 32] UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE SECOND CIRCUIT

No. 48—October Term, 1941

(Argued November 13, 1941. Decided December 22, 1941)

EMIL H. STRASSBURGER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition to review a decision of the United States Board of Tax Appeals

The taxpayer seeks reversal of an order of the Board determining a deficiency in income tax for the year 1936. Affirmed.

Before: Swan, Augustus N. Hand and Chase, *Circuit Judges*

Leo Brady, Attorney for Petitioner.

Samuel O. Clark, Jr., Assistant Attorney General; J. Louis Monarch and Morton K. Rothschild, Special Assistants to the Attorney General, for respondent.

[fol. 33] SWAN, *Circuit Judge:*

This appeal presents a case where the owner of all the common stock of a corporation, which had only common stock outstanding, received a stock dividend of 50 shares (par $100 per share) of non-voting, cumulative 7% preferred stock declared out of surplus accumulated subsequent to February 28, 1913. Appropriate entries were made in the corporation's books on account of the dividend, the surplus being decreased by $5,000 and the capital stock increased by the same amount. The question is whether such stock dividend was taxable income to the sole stockholder upon receipt thereof in 1936. The preferred stock has not been cancelled or redeemed by the corporation, nor has it been sold by the petitioner. The Board ruled that the stock dividend was taxable income.

In *Eisner* v. *Macomber*, 252 U. S. 189, it was held that a dividend payable in common stock to holders of common stock was not constitutionally taxable as income because

distribution of the dividend produced no change in the stockholders' proportionate interest in the corporation's net assets. Following this decision, Congress provided in section 201(d) of the Revenue Act of 1921 that a stock dividend was not taxable. 42 Stat. 228. This provision was reenacted in the later revenue acts until the case of *Koshland* v. *Helvering*, 298 U. S. 441, disclosed that certain stock dividends could be considered taxable income. The Revenue Act of 1936, enacted after the *Koshland* decision, provided in section 115(f), 49 Stat. 1688, as follows:

"(f) Stock Dividends.—

(1) General Rule—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the [fol. 34] meaning of the Sixteenth Amendment to the Constitution."

It is implicit in this provision that Congress intended to tax stock dividends to the full extent of its constitutional power; and so the Regulations expressly declared. Art. 115-7, Reg. 94.

The question before us therefore comes down to whether a stock dividend in preferred stock to the sole owner of the common stock, which was the only class of stock outstanding, may be regarded as income within the meaning of the Sixteenth Amendment; in other words, whether the case is governed by *Eisner* v. *Macomber* or by *Koshland* v. *Helvering*. In the latter case at page 445 of 298 U. S. the court said:

"Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old,—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old,—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stockholdings represented he receives income. The latter type of dividend is taxable as income under the Sixteenth Amendment."

The *Koshland* case involved a dividend of common stock to preferred stockholders. In *Helvering* v. *Gowran*, 302 U. S.

238, the court considered a dividend of preferred stock to common stockholders. Mr. Justice Brandeis, speaking for the court, said, at page 241, that under the rule declared in the *Koshland* case Congress could have taxed this stock dividend. This expression of opinion would dispose of the [fol. 35] case at bar were it not for the fact that in the *Gowran* case, as in *Koshland*, there were two classes of stock outstanding when the dividend was declared; hence the stock dividend in each of those cases changed the stockholders' proportionate interests in the net corporate assets. Here, however, there was only one class of stock outstanding and but a single stockholder, who after, as before, the dividend owned the entire beneficial interest in the net assets of the corporation. Nevertheless the rearrangement of corporate capitalization so that the petitioner held preferred as well as common stock did change the character of his corporate ownership. The preferred stock had the prior right to dividends and a preference on liquidation of the corporation; and these rights could be disposed of without affecting the voting control residing in the common stock. The petitioner received property rights of actual and exchangeable value and representing an interest different from that which his common shares represented. As the Circuit Court of Appeals of the Seventh Circuit said in the *Gowran* case, 87 F. 2d 125, 127:

"The legal quality of what the taxpayer has after such distribution is different from that which he had before. Therefore the distribution is one of property rights of variant character from those which he previously owned, and as such, therefore, constitutes income which could be taxed."

See also *Commissioner* v. *Tillotson Mfg. Co.*, 76 F. 2d. 189 (C. C. A. 6); *Kelly Trust* v. *Commissioner*, 38 B. T. A. 1014 which was affirmed in an opinion (1939 C. C. H., Vol. 4, Par. 9624) later withdrawn, 106 F. 2d 1002 (C. C. A. 8). In our opinion the case at bar is governed by the *Koshland* principle rather than by that enunciated in *Eisner* v. *Macomber*. It must be conceded, however, that the question is not free from doubt. Certain commentators have ex- [fol. 36] pressed the opposite view. Mertens, Law of Fed. Income Taxation 1939, Cum. Supp. p. 295 *et seq.*; C. C. H. Standard Fed. Tax Service 1941, Vol. 2, p. 3096. Compare

also *Sprouse* v. *Commissioner*, 122 F. 2d 973 (C. C. A. 9). Order affirmed.

CHASE, *Circuit Judge* (dissenting):

I cannot help but think that my brothers have failed to give recognition and effect to the substance of the difference between *Koshland* v. *Helvering*, 298 U. S. 441 and *Eisner* v. *Macomber*, 252 U. S. 189.

If, after the receipt of a dividend paid in stock, a stockholder has not only additional stock but also stock of a different character his proportionate interest in the net assets of the corporation may have been changed where there are several, or more, stockholders. Whenever it has been and the change is by way of increase in his proportionate interest in the net value of the corporation there is a receipt of income which Congress has taxed. *Koshland* v. *Helvering* (*supra*), 298 U. S. 441. But surely the case just mentioned must rest upon firmer ground than a change in the kind of shares of stock a stockholder has as the result of a dividend of stock on stock. There must also be a change in his proportionate interest in the corporation's net assets in order to have what is known as a "realization" of income. When, as in this instance, there has been no such change for the simple reason that the stock dividend did not bring that about in the holdings of one who, both before and after it, owned exactly the same interest in the net value of the corporation, because he always owned it all, the real basis of decision in the *Koshland* case is lacking and that of *Eisner* v. *Macomber* (*supra*), 252 U. S. 189, does, I think, apply. See *Sprouse* v. *Commissioner*, 122 Fed. (2) 973.

I would reverse.

[fol. 37] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 7th day of January one thousand nine hundred and forty-two.

Present: Hon. Thomas W. Swan, Hon. Augustus N. Hand, Hon. Harrie B. Chase, *Circuit Judges*.

EMIL H. STRASSBURGER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. Roberts, *Clerk.*

[fol. 38] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Emil H. Strassburger v. Commissioner of Internal Revenue. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Jan. 7, 1942. D. E. Roberts, Clerk.

[fol. 39] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 40] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed May 11, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.